

2085  
OPINION  
AND  
COMMENT



The Objectives of Economic Planning

The Ethics of Taxation

Industrial Mobilization for National Defense

Financing National Defense

.

COMPILED BY THE  
BUREAU OF BUSINESS RESEARCH

PUBLISHED BY THE UNIVERSITY OF ILLINOIS

MAY 13, 1941

---

---

# OPINION AND COMMENT

## CONTENTS

	PAGE
The Objectives of Economic Planning.....	1
CLAUDE D. BALDWIN	
The Ethics of Taxation.....	9
CHARLES J. GAA	
Industrial Mobilization for National Defense.....	15
GEORGE A. STEINER	
Financing National Defense.....	25
CATHERINE G. RUGGLES	

This publication of the Bureau of Business Research of the University of Illinois rests upon the belief that business men of the State will appreciate interpretative comments on current events. Because studied opinions on the significance of current trends are often more thought-provoking in the conduct of business affairs than mere tabulations of data would be, the Bureau supplements its research bulletins by producing *Opinion and Comment* as another type of service to the State.

The opinions expressed in the articles are, of course, the personal views of the respective authors and not necessarily those of the College of Commerce or the University.

Please notify the Bureau of Business  
Research of any change of address

## EDITORIAL COMMITTEE

H. W. HUEGY

A. C. LITTLETON

H. K. ALLEN

[Entered as second-class matter December 11, 1912, at the post office at Urbana, Illinois, under the Act of August 24, 1912. Acceptance for mailing at the special rate of postage provided for in section 1103, Act of October 3, 1917, authorized July 31, 1918.]

# The Objectives of Economic Planning

CLAUDE D. BALDWIN

Department of Economics and Business Administration,  
West Virginia University

IN CURRENT discussions of economic planning, surprisingly little attention seems to have been paid to the objectives of planning, though much has been written on the so-called necessity of planning. Is it not reasonable for the critic and the adherent alike to ask for what we are planning? If not just for planning's sake, are we desirous of planning for more output, more leisure, greater equality, military preparedness, or what? For convenience in summarizing the argument, those problems of objectives which pertain to that elusive concept, social welfare, have been divided into three parts: (1) the arbitrary elements of planning which directly concern the organization of production; (2) the problems associated with the concept of the Social Good, or ethical valuations; and (3) the implications of planning to democratic institutions and personal freedom.

In a system of more or less libertarian planning, there are certain arbitrary elements—arbitrary in the sense that they do not depend on the freely expressed preferences of individual economic agents. The decisions relative to these elements must, in the nature of things, be taken by the state, and only through its governmental machinery can individuals voice their preferences one way or the other. The most important of these elements which per-

tain rather directly to the economical direction of the productive machine are:

1. The allocation of resources between communal and individual consumption.
2. The allocation of resources between present and future consumption.
3. The choice between work and leisure.
4. The weight to be given extra-monetary elements—social costs.
5. The initial decision as to what is to be produced.

How much of the community's resources should be devoted to the production of goods and services which may be occasionally consumed, e.g., education, health, defense, etc., is a question which, because of the very nature of these services, makes impossible individual preferences; in this realm authoritarianism seems to have some merit. There is something to be said, it seems, for dictating to the people that they should send their children to school, that they should protect one another from disease, and so on. These items are apt to be overlooked if left to individual decision, since the original neglect of matters highly important to the community as a whole may seem insignificant to individuals.

The decision as to the amount of capital to be accumulated for the technological advance of society is, likewise, placed in the hands of the state when ownership of capital goods (and savings) is vested therein. Should the amount of capital



accumulated be large or small? Should it be great enough to reduce the net productivity of capital to zero, and the rate of interest, therefore, to zero? This question remains unanswered and unanswerable at the present moment; only through actual experiment can the answer be determined. Soviet Russia seems to have emphasized capital accumulation as a means of industrializing the nation: but whether a technically efficient country like the United States need adopt such a rapid rate of accumulation is open to serious doubt. At any rate, the authority in charge of production, influenced by the policy laid down by the governing bodies, must ultimately make the decision, which from an individual point of view will be arbitrary.

The choice between more work and less leisure and more leisure and less work is a similar case. By and large, most individuals in any society have that decision made for them; most of us still work by the time clock. We punch in our time and clock out according to the conventional standards, let us say on the average of an 8-hour day in this country at present. It is conceivable, however, that if productivity increased as a result of planning, there would be some justification for diminishing the amount of time spent at work and increasing the amount devoted to the pursuit of other activities.

By social costs are meant those elements which, in our present society, receive little or no monetary expression in the costs of producing a particular good or services, e.g., the deterioration of workers' health,

smoke from obnoxious industrial chimneys, etc. Though these elements are "costs" to the community in the sense that they involve disutilities, they do not receive adequate reflection in the market price of goods; the ill-health of workers, for example, is an item of personal expenditure not often borne by the employer in whose factory that health has been impaired. To what extent social costs may be given weight in any society depends upon some judgment based upon experience and observation—some rule-of-thumb. At present no tool seems to be available for reducing such imponderables to monetary terms and thus expressing them in price; this would also be true in a planned economy.

A curious misconception about the nature of the productive process seems to have arisen in respect to whether in a planned economy consumers would "dictate" *what* is to be produced. It is submitted that consumers commonly exercise only a negative vote on such matters; they express their preferences for goods *already produced*, but because of their essentially passive nature, they seldom exercise much influence on what will be produced and offered to them in the first instance. Decisions as to whether new inventions shall be utilized immediately or postponed and whether products shall be altered in an attempt to adapt them to the requirements of various bodies of consumers in different localities, are, after all, matters for the producers to work out in any society.

Reviewing as a whole this ques-

tion of arbitrary decisions, it seems that the decisions in question are, in part at least, of the same kind as those already made arbitrarily under capitalist individualism. Very little attention has hitherto been given to social costs except by the legal enactments of the state. They refer to fields of choice, moreover, in which individual decisions can never be more than very rough-and-ready and are notoriously inadequate, and in which little loss of welfare seems to result from drawing the line a little above or a little below some ideal point. Perhaps one could offset against these elements the greater gain which might result from greater equality in income, prestige, and power. It is when we discuss what is in the general welfare, what is the Social Good, that we face a serious conflict of opinion. It is readily evident that each of the above-mentioned five decisions impinges upon this concept and raises the question as to whether a decision one way or the other will increase or decrease the general welfare.

Clearly we are no longer in the realm of economics as traditionally defined when we begin considering ethical value judgments of the ends for which we should plan. What seems to some persons to be a contribution to the general welfare may seem diametrically opposed thereto in the opinion of others. One school of thought, including Hegel, Green, Bosanquet, and others, believes that what is in the welfare of society is determined by the degree to which individual wills are in harmony with a collective will, and that, therefore,

true morality consists in bending the individual will to that of the state. Fascism and Naziism at present exemplify this creed. On the other hand, some persons believe that individuals should determine what is best for them, what is promotive of the general welfare. Theories of the Social Good itself may perhaps be omitted here, but it is extremely important to realize that today we are faced with this choice between social philosophies; it is dangerous to consider the United States, for example, as being free from either element.

Economic planning clearly involves something more than the mere adjustment of means to ends; it involves also the conscious choice of ends. When the end is given and precisely known, the task of finding the best means towards it, though practically difficult, is at least clear-cut. In times of war there is general agreement that immense quantities of shells and guns must be turned out in the least possible time. This could be planned for. But in normal peace times, could we ask the citizens of any country to forgo other ends with an equal degree of unscrupulous disregard for individual feelings? To what end should planning be directed? Do we seek national power or the happiness of individual citizens? Do we want to be a self-sufficing community or a more or less specialized part of a world system? Do we want a large population or a small one? Do we prefer an immense equipment for satisfying material wants by producing commodities or a high degree of mental training to



enjoy them? Such questions are merely general; but it is obvious that if we choose one of these ends to the exclusion of the others, serious problems may arise. It seems possible to weigh the advantages of pursuing one end as compared with another, and to follow a number of ends simultaneously; the danger is that society may become lopsided by its emphasis upon one end to the omission of other ends equally desirable to many persons. Until some sort of solution is offered and accepted, however, the advocates of planning are building castles of words.

To those who speak optimistically of the vast and apparently painless potentialities of planning in the social realm, it may be less pleasant to realize that the eradication of any social evil must be paid for, and that if we dislike the price of change we must put up with the ills we have. Ultimately we may measure the extent to which individuals are willing to pursue one objective rather than another by asking them to pay for their choice the price of forgoing the other goals. American planners typically have set the goal of greater output which, they assert, will lead to prosperity and promote social progress. America, as someone has remarked, has a philosophy of prosperity, a worship of material wealth, and in keeping with that philosophy many persons have advocated increasing and ever-increasing production. Gadgets and more gadgets seem to be the desideratum of these planners.

But once we ask them to compare the advisability of letting people

have a little more leisure in which to enjoy all the gadgets which the efficient technical machine has turned out, it becomes evident that some are less sanguine about their original proposals. Clearly there may be an essential incompatibility between more output and more leisure. To assert that one is paramount and exclude the other is nothing short of irrational.

Certain advocates of planning have been equally naive in their belief that greater equality of income would result in a millennial era for mankind. Strict equality per capita seems incompatible with individual differences of ability; moreover, if all were given equal incomes it is questionable whether they would perform their work as efficiently as when some differences in income or in social recognition are employed as incentives. The use of non-pecuniary incentives seems limited to a narrow segment of the total working population, though they may serve as an important auxiliary to pecuniary rewards. Short of giving some differential recognition to individuals, coercion becomes the necessary tool whereby laborers may be allocated among different occupations in accordance with the production plan. Here we have a case of two incompatibilities; strict equalitarianism becomes incompatible with both individual liberty and productivity.

A misconception which has pervaded the literature on socialism, communism, and a planned economy is the assumption that human beings will be different, will have more altruistic motives, will be willing to

work for the "Social Good" without stint, once the new regime is in existence. Clearly no accurate prediction can be made on this matter, but there seems to be grave doubt that we should permit ourselves the pleasant delusion that human beings, creatures of habit, emotions, and egoistic impulses, will suddenly change their nature overnight or within the near future. Although this is a practical problem whose solution must wait upon experience, it would be more in consonance with reality to take man as he is—good and bad—and envisage the problems that may arise from his seeming "social unsociableness." On this basis it may be affirmed that the shibboleth of the class conflict of the Marxian doctrines may be shown up as the delusion it is; that the communist doctrine "from each according to his ability, to each according to his needs," can be adopted only within very narrow limits; and finally, that the "profit motive," the egoistical psychology of most human beings, must be utilized in order to induce them to perform their best services and to offer themselves for employment in those fields in which they are most needed. To make this statement, however, is not to deny the possibility of a greater equality in income than exists today; but differential wages seem the necessary minimum for the successful planning of production, short of coercing labor by dictatorial decree into those occupations in which the state considers it would be most useful—to the state. Would-be dictators may be well-advised to consider the practical desirability of capital-

izing on their laborers' egoistic motives by proffering them jobs on the basis of free choice and by rewarding them on the basis of services rendered, rather than on some other basis which may entail coercion accompanied by its inevitably diminished productivity. It scarcely needs demonstration today that forced labor is less efficient than free labor.

Unless all persons have an equally moronic level of capacity, individual differences will arise, and with them the necessity for differences in social rewards—in the form of either non-pecuniary rewards or monetary wages. Some have gone so far as to say that human beings are very much interested in the differences which exist between different individuals and between groups of individuals and that competition among individuals is an essential ingredient of living.

Liberty, that ingredient of life which most of us cherish beyond our desires for more wealth or greater equality, is endangered when planners propose absolute equality or emphasize productivity to the exclusion of other equally desirable objectives. This is not to say, of course, that greater equality than exists today might not well be accomplished without imperiling individual freedom of action. But it does imply that the selection of a socially comprehensive goal of strict equality—which implies coercion in respect to occupational choice, if not to choice of what shall be consumed—or of greater and ever greater production, may meet with strenuous objections on the part of many per-



sons on the ground that liberty is thereby curtailed.

If individuals in society realize the significance of the choice and the implications that will inevitably follow from the emphasis upon one objective rather than another, the purpose of this discussion will have been attained. There seems to be, however, no reason for us to agree with critics that society must choose only one socially comprehensive goal, and that it can not pursue several ends simultaneously. Heterogeneity of ends is equally as possible for society as for individuals; the advantages of a little more output and a little less leisure, a greater degree of national defense and a little less of other things, and similar decisions, can be weighed in the balance and some value judgment arrived at. The conclusion is simply that in any society these arrangements are never absolutely fixed; they are always subject to change by the conscious or unconscious choice of that society.

To Americans, in the chaotic world of today, the preservation of our democratic institutions may seem significant enough to offset the advantages of greater equality, greater production, and the rest of the desirable things which have been promised by planners. Certainly democracy is a costly way of running a country, and there is much to be said for dictatorship or authoritarianism in general. No one would deny the possibility that a dictator could, given the resources of the United States and its fairly skilled labor force, construct a highly efficient productive machine, or that

he could create a powerful military state, armed to the teeth. Perhaps he could with equal dispatch level incomes and produce greater equality among individuals. But if the price of dictatorship, or rather of the loss of running our country for ourselves—in which are included all the civil liberties of speech, press, religion, etc.—had to be paid, it is likely that a good many persons would be willing to forgo the desirable objectives of greater wealth and equality.

There are those who see in planning the road to dictatorship; Professor Lionel Robbins once remarked that "if you scratch a would-be planner, you will find a would-be dictator." And yet this need not be the case. Like any other decision on the institutional arrangements of a society, democracy may be preserved as one of a heterogeneity of ends. But society must be willing to pay the price for organizing itself in a certain manner—either democracy or dictatorship. It must be content to see the productive machinery produce a little less in order that laborers may choose their own occupations; it must be patient at the delays in Congressional debates on policy; it may have to endure some differences in wealth and income. All these are ends which may be incompatible with one another if carried to their extremes.

Some persons believe the mere assertion that planning may be carried on under a democracy establishes a case; they would be well-advised to scrutinize their earlier sanguine assumptions. The dangers to the political heritage of this country



in the introduction of economic planning are too often minimized by planners. On critical examination, there is little evidence that large masses of men act together more harmoniously in any other field or under any other form of organization—be it work or play or the pursuit of intellectual or religious values—than they do in what is called business. Once this fact is admitted, the danger is clear that one group may seize control of the political machinery of the state and wield it against other groups. The price of retaining a fairly workable democratic system is eternal vigilance.

Special attention is called to one fact that seems to have escaped the notice of many planners. That fact is: under economic planning the state owns the means of livelihood of each and every citizen; it is the sole employer and the sole seller. It is easily seen that control over a man's means of livelihood means control over his life. The state could exercise its monopolistic power in the economic realm to re-enforce its vast power of sovereignty in the social realm; there would be no appeal from its decision so far as the individual was concerned. It would be possible, as some have suggested, that instead of planning production, the state might begin to plan people. It could plan wants through effective propaganda and through the educational machinery, which would be state-controlled; it could plan what to produce, how much to produce, the amount of work, leisure, capital accumulation—in fact, every phase of life. The identification of

economic and political sovereignty offers to unscrupulous individuals tremendous possibilities for exploitation.

It is certain that the advocates of planning have been somewhat naive in their arguments as to the results which would follow from merely changing the form of economic organization in a society. On the one hand, they have greatly exaggerated the significance of economic interests in comparison with other motives and values; on the other, in the economic sphere itself, they have attributed to the system of organization much that is really due to the vast scale of social relations connected with modern technology. They forget that any large-scale organization necessarily becomes impersonal and that in this regard political process resting on campaigning, machine organization, and voting is fully as bad as market relations reflected in the price quotations of a board of trade or stock exchange. Planners and Socialists alike have not taken into account the complexity of the economic system itself, much less its implications in the social realm.

They have failed to envision adequately the dangerous effects which a transformation in the economic sphere might have on such institutions as the family and religious organizations and upon art, literature, and cultural progress in general. The Marxian materialistic interpretation of history is not a satisfactory appraisal of the historical development of mankind.

But the critics must also be reminded that they have fallen into

the same trap, by and large, by insisting that these material alterations in institutional arrangements are not only *prima-facie* evidence that the whole of society will be changed, but also absolute proof that planning contains inherent contradictions which will inevitably bring about its decay and that state ownership always implies the destruction of liberty, democracy, and cultural values.

It may well be that the road to dictatorship will be paved with the good intentions of economic planners; their appalling shortsightedness is extremely intriguing material for a would-be dictator. But it seems that, if all the problems are realized, in practical life this need not be the case.

Moreover, it may be admitted that no serious thinker can study our social system without becoming aware of its defects, and that a recognition of these may make so deep an impression upon him that he may begin to have doubts as to whether the existing social structure can or should last. If, in addition, he believes wholeheartedly in the progress of human nature and in the evolution of altruistic motives, then he may eventually reach the point of predicting that these motives will one day become dominant; he may perhaps subjoin a second prediction that a renewal of the social order will one day follow of

its own accord. Perhaps the conclusion on such projected proposals as planning and socialism is always determined by the allegiance of an individual to the pessimistic, the optimistic, or the skeptical school of thought. As yet there seems to be no adequate appreciation of all the problems involved when a way of life and not just a change in institutional arrangements is being discussed.

The chief criticism that is applicable to both sides is that too many have exaggerated the effects which institutions have upon man's inner nature. Socialism, and planning as well, has emphasized the external of man's life almost to the utter exclusion of his inner nature. But it is the spirit of society, it is the inner nature of human beings, with which we are ultimately concerned even when we propose planning as a way to modify or completely alter that nature. It seems highly improbable that a mere change in man's external environment will effect any revolutionary change in his internal nature. The conclusion seems to be, therefore, that economic planning, together with socialism and communism in so far as they propose to plan, is too external in nature. Both sides forget that democracy, liberty, culture, religion, and morality are spiritual things, internal to a society; they forget that "The kingdom of heaven is within you."



# The Ethics of Taxation

CHARLES J. GAA

Department of Business Organization and Operation,  
University of Illinois

TAXATION, like all other institutions and activities that have their roots and effects in society and the social relationships of the human family, is vitally concerned with ethics. Ethics is the study of human conduct as it concerns right and wrong, good and evil. The social order and social institutions must be in accord with that which intelligent man considers ethically correct. Nothing can survive for long, especially a fiscal system, unless it has the sanction of the people. In order to obtain this approval, the system must be just; it must not violate individual rights unless such violation is necessary for the common good.

The state clearly has the right to use all its powers to promote the social and economic welfare of its people. The use of taxation to improve the general welfare is therefore one of the powers of government.

The construction of a satisfactory financial plan for a governmental unit requires a very careful observance of ethical principles. Taxpayers must be shown that their rights are not to be invaded and that justice will be observed. If such assurance is not given, the taxpayers will rebel against paying and will wreck the fiscal system, thus embarrassing the government. The far-

reaching effects of a tax rebellion are well illustrated by the American revolution against Great Britain. A recent and localized rebellion against taxation took place a few years ago in Cook County, Illinois, when many of the residents of that area refused to pay taxes levied under an assessment which they considered unfair.

The shifting and incidence of the tax burden must be studied in order to determine upon whom the weight will ultimately fall. The fairness of a tax can be judged only by finding out who finally bears the burden and whether he can do so with no resulting injustice.

Care must be taken to insure that taxation does not crush or retard any desirable activities or functions of individuals or of business concerns, because excessive taxation has the power to destroy the thing upon which it is inflicted. Undue taxation might leave its impress on the very character of the persons upon whom it was levied, and private initiative and resource might be discouraged or stifled if the products of such initiative were confiscated through taxation.

It is far easier to justify taxation in general than to justify any specific tax, because people are often of the opinion that some particular tax is unfair to them personally. There

is no unfair infringement of a person's individual liberty in requiring him to pay taxes, since taxation is necessary to bring about social development. Such development is important enough to justify society in forcing its members to assume some of the burdens and responsibilities required to bring it about.

John Stuart Mill, in his essay *On Liberty*, said:

"Though society is not founded on a contract, . . . every one who receives the protection of society owes a return for the benefit, and the fact of living in society renders it indispensable that each should be bound to observe a certain line of conduct towards the rest. This conduct consists, first, in not injuring the interests of one another . . . and secondly, in each person's bearing his share (to be fixed on some equitable principle) of the labours and sacrifices incurred for defending the society or its members from injury and molestation."

The collection of taxes has gradually progressed from the gift phase to the duty status, and from the duty status to the present-day compulsion stage. In earlier times, it was customary for individuals to contribute their services directly to the government (e.g., military, road repair, etc.) but now it is more usual for money taxes to be paid and for special employees, engaged by the government, to perform these services. Taxes can be justified only if they are being collected to finance services and functions which can be performed more satisfactorily by the state than by the individuals themselves.

Among the different theories of fairness and justice in taxation which have been advanced at various times and in various places are

the following: benefit received, ability to pay, recovery of cost of services performed, equality of sacrifice, and "what the traffic will bear."

The benefit principle was one of Adam Smith's four canons of taxation. It is a very natural theory, because it is normal for one to pay for the benefits or favors he receives. The expenditures of a state benefit its residents and those whose property is situated in it. In return for these benefits, the beneficiaries should repay the state.

The theory that taxes should be paid in proportion to the benefits received is satisfactory as a general proposition, but it encounters difficulties when applied to individual cases. Some benefits, such as life, liberty, pursuit of happiness, police protection, and military and naval protection, are supplied to all and are sufficiently tangible to be observed. No accurate measurement of these benefits is feasible, however, when an attempt is made to apportion such services justly among individuals. It is impossible to determine exactly how much benefit any particular person receives from each of these services.

Moreover, the question arises as to whether an individual should be taxed on the basis of the benefits available to him or on the basis of the degree to which he has actually taken advantage of them. For example, he may have the opportunity to patronize a free library, or to enjoy the recreational facilities of a public park, and yet he may never utilize these benefits.

Even if benefits to individuals could be measured, an additional and



even more difficult problem would still remain to be solved. Frequently, those who receive the most benefits are those who are incapable of paying much, if anything at all, for them. Inmates of charitable institutions receive their food, clothing, shelter, and amusement from the state, but are usually entirely unable to make any return for these benefits. Strict adherence to the benefit principle would demand that such benefits be denied to those unable to pay for them, and the unfortunate would be forced to forgo certain things that contribute both to their own welfare and to that of society.

Experience has shown that in many cases certain other theories have proved to be more practicable and more conducive to justice than the benefit theory. Ability to pay, which is the principal test now advocated, has assumed importance in income and inheritance taxation. There is some relationship, however, between ability to pay and benefits received, because those best able to pay usually receive the most benefits from government. The benefit principle works fairly well in the case of certain licenses, gasoline taxes, and special assessments.

The Socialists, who are among the foremost advocates of the ability-to-pay doctrine, hold that the forces of the economic and social order have been responsible for a maldistribution of wealth, and that a redistribution of wealth should be effected by taxing the rich at steeply progressive rates. If carried far enough, however, such a procedure might lead to confiscation.

In judging ability to pay taxes, it is extremely important to remember that mere possession of wealth does not create tax-paying ability. If a man who has been given a very valuable diamond does not sell it, he will have no increased ability to pay taxes. His income will not be increased by mere possession, and most fiscal systems now attempt to measure ability by the amount of income received.

Another theory, that of equality of sacrifice, is very similar to the ability-to-pay theory; it simply attacks the problem from a different angle. The assumption is that taxes should be levied in such a manner as to equalize the sacrifices involved in the payment of the tax. The wealthy should contribute more than a merely proportionate share. Each additional portion of income received has a slightly smaller utility to the recipient than the preceding portion had. Therefore, the recipient can part with a larger portion of each succeeding increment without an increase in sacrifice. Progressive tax rates should be used to bring about this equality of sacrifice in the tax burden.

Proportionate, progressive, and degressive tax rates; tax exemptions; differentiation between earned and unearned incomes—all these are devices which have been suggested to further the recognition of the ability-to-pay and the equality-of-sacrifice theories of taxation.

A proportionate rate is one which is the same for all incomes, regardless of size. Some arguments in support of the use of such rates are (1) taxpayers should be left in the

same position relative to each other after the tax is imposed as they occupied before the levy, (2) the tax would be more definite and less subject to abuse caused by the use of arbitrarily preferential rates, (3) abandonment of the universal use of the same rate might lead to confiscation, and (4) the taxation of larger incomes at a higher rate than that used for smaller incomes is equivalent to laying a tax on industry and economy and to penalizing people for having worked harder or saved more than their neighbors. The principal objection to proportionate rates—and it is a serious one—is that they are not consistent with the theories of ability to pay and of equality of sacrifice.

Progression in taxation involves the use of tax rates that increase as the base increases. It gains its chief support from the fact that it closely follows the ideas of ability to pay and of equality of sacrifice. Progressive rates are favored by those who desire to reduce large fortunes, and also by those who advocate governmental regulation and restriction of certain activities, industries, or institutions.

Aside from the matter of regulation through taxation, a good fiscal system should levy on those things which can be spared easily, rather than upon those things which will be severely missed. Large accumulations of wealth contain a larger proportion that can be spared than is possible for small incomes. The least price and reward that is paid to a producer is based upon the marginal individual. Those who are better producers can gain a larger

surplus than can the producers who merely have their costs returned to them. It should be possible to tax some of this surplus without cutting down on the supply, without raising prices, and without shifting the tax burdens to others. To make this plan operate well, it is necessary to restrict progression below a point at which the base of the tax and the initiative of the taxpayers would be destroyed.

Degression involves the use of rates which increase as the tax base increases, but at a decreasing rate; hence it is virtually a modified progression. The usual method of applying degression is to allow all taxpayers a tax exemption up to a certain point, and to apply progressive rates beyond that point. Danger of confiscation is thus eliminated, but adherence to the ability-to-pay theory is not so close as when straight progression is used.

Regression in taxation is the exact opposite of progression; regressive rates decrease as the base of the tax increases. This method of taxation has no ethical justification, because it violates the principles of ability to pay, equality of sacrifice, and benefits received; it merely placates the strong at the expense of the weak.

Regressive taxation often results unintentionally from an existing tax system. In most cases, real property and certain very evident and tangible types of personal property are assessed and taxed more carefully and completely than other kinds of personal property. This difference in treatment is either intentional or results from the fact that some kinds of personal prop-



erty can easily be hidden from taxation. Perhaps a particular tax is not at fault when the dishonesty of the people causes it to produce a regressive effect. However, a good tax law should discourage evasion and distortion of taxation as much as possible; at least, it should not be so constructed that one class of individuals can evade taxes while another is held to strict accountability. The general property tax is regressive, because poorer people usually have a larger part of their total property in easily assessed and taxable form than more wealthy persons. Any tax that has a uniform rate is regressive in effect, because it falls more heavily upon individuals with small incomes than upon those with large incomes.

Provision for tax exemptions in a fiscal system is very important to insure justice, to promote certain types of activity, and to aid in the administration of the tax system.

Ordinarily, the property of a governmental unit is exempt from taxation by other governmental units within the same country. If one governmental unit could tax another, unceasing warfare between governmental subdivisions could be carried on by means of taxation. It has been recognized, however, that in many cases the exemption of the property of a governmental subdivision results in a heavier burden on the taxpayers of the assessing governmental unit.

Benevolent, religious, charitable, and educational institutions, which are extremely important to the mental, moral, physical, and spiritual improvement of society, are

usually tax-exempt. Communities that do not have such institutions are generally unprogressive and undesirable places in which to live. Every encouragement should be given to such organizations in order to foster their establishment and growth, but care must nevertheless be taken to be assured that they have been founded not for private gain, but for public welfare, since tax exemption is a subsidy to the one exempted and a burden to those not exempted.

Another very significant reason for tax exemption is the maintenance of the general standard of living. A certain "minimum of subsistence" must be exempted in order to allow the taxpayer to keep up a standard of living equivalent to that of a reasonably comfortable person. The state must not deprive an individual of so much that he must either go without the necessities of life or become an object of charity.

Exemptions are frequently made for the purpose of attracting industries to certain communities. Such procedure is usually uneconomical, because if the location is especially favorable for an industry, that industry is likely to settle in the community without being subsidized. If a tax exemption is to be granted, it should be shown clearly that the industry will aid the community, because the other members of the community will be forced to bear the exempt industry's share in the burden of community upkeep.

Sometimes an effort is made to lighten the burden of taxation on so-called *earned* incomes, as contrasted with *unearned* incomes.

Earned income is that which is directly dependent upon the efforts of the recipient. The income of poorer persons is usually of this type, and ordinarily it is used up in providing for the necessities of life. Unearned income is that which is received from investments, inheritances, other non-labor sources, and excessive salaries and fees.

Many persons oppose discrimination in taxation between earned and unearned incomes on the score that the reward for abstinence from consumption is just as worthy as the reward for labor, and that savings and investments merely represent stored-up labor. This line of reasoning is valid if the unearned income is derived from savings and not from gifts and inheritances, because income derived from past labor saved is really about the same in nature as current wages. Discrimination in the taxation of earned incomes should be based upon the sacrifice theory rather than upon the benefit theory, because society has contributed its services to aid in the production of all incomes, earned or unearned.

The cynical theory of taxation is actually prevalent in many fiscal systems, although it has no logical or ethical foundations. It is well stated as follows: "Pluck the goose that squawks the least." No effort is made to approximate justice; all that is done is to get the revenue from the easiest source.

Finally, there is the utilitarian principle of government to be considered. It forms the basis of the idea that a tax system should aid in the promotion of the greatest

good of the greatest number of individuals. In some cases, private rights and liberties should be invaded, if, in so doing, the good of society can be furthered.

Taxation for regulation or restriction comes under the utilitarian theory. Regulatory taxation does not give much weight to the amount of benefit the taxpayer has received, his ability to pay, or the matter of equality of sacrifice. In fact, the government violates these aspects purposely in order to discourage the object of taxation. If the product of a certain industry causes direct injury to society, or if it displaces other more worthy products, that industry or its product is a fit subject for restrictive or destructive taxation.

Sometimes, repressive taxation results incidentally to a more important purpose, that of taxing the least necessary or least beneficial things more heavily than the indispensable items. It is far better to tax tobacco, liquor, and dog races than to burden basic commodities such as food, clothing, fuel, and shelter.

In general, a system of taxation should result in a net improvement to a community and its members; otherwise it is not justified. While each person should feel some burden of the government from which he receives his benefits, in order to make him realize that the government is his, and to give him a sense of responsibility, he should not feel crushed or downtrodden under the weight of taxation; the least possible sacrifice should be required of him.

Taxation is the very heart of gov-



ernment, because government depends on the revenues from taxation for providing its services. Any successful tax system must be founded

on ethical principles, or else it will incur opposition and enmity, and society will be deprived of the funds needed to carry on its functions.

## Industrial Mobilization for National Defense

GEORGE A. STEINER

School of Business, Indiana University

IT IS not necessary to plead the case for a certain amount of control over economic activities in periods of great national emergency. In the past year, increasing control and regulation over industry and trade has been exercised by the Federal government in the interests of national defense.

The general significance of this movement may be better appreciated if it is considered in the light of historical perspective and future possibilities. In this connection, the following questions come to mind: What was the industrial mobilization experience of this nation during the World War? What industrial mobilization plans, if any, were formulated during the peace following that conflict? What progress has been made in mobilizing industry for defense? In the expansion of the defense program or in the event of our involvement in war, what directions are industrial mobilization controls likely to take? It is the purpose of this article to

sketch brief answers to these questions.

A recognition of the need for mobilizing human and material resources in wartime goes back to very early times. Yet before 1914 no world power seems to have realized fully the importance of organizing the economic system for the prosecution of war. Before the World War had advanced very far, however, military leaders, who prior to the outbreak of hostilities had devoted their principal attention to matters of military strategy rather than of economic organization, found themselves assuming closer and closer control over economic activities. But much valuable time had already been lost.

Despite the lessons taught by three years of conflict abroad, together with the insistence on adequate mobilization by certain groups at home—to say nothing of our sad experiences in economic planning in previous wars—the United States in April, 1917, found itself ill-prepared

to meet the demands of warfare. A number of agencies were established prior to our entrance into the war, but no adequate plans had been formulated for solving the perplexing economic problems which would inevitably require solution. It was only after almost a year of experimentation which led to chaotic conditions that a workable industrial mobilization plan was found.

Suggestions for preparing mobilization plans in the event of war had come from a few interested students of the problem as early as 1915. In that year the National Advisory Committee on Aeronautics and the Naval Consulting Board were established to study certain aspects of the problem, but it was not until mid-1916 and the passage of the National Defense Act that responsibility for preparing plans to mobilize men and materials in the event of an emergency was placed upon the War Department. Not until August was an agency, the Council of National Defense, established to coordinate the mobilization of national resources. The Council was composed of six Cabinet members and a small Advisory Commission of private citizens appointed by the President.

This agency found itself in a difficult position. In addition to its lack of authority, strong opposition of pacifist groups and uncertainties as to the future course of events hampered its effectiveness. In spite of these unfavorable circumstances, however, it did accomplish much. Up to the outbreak of war it had acquired for its staff a number of civilian experts, it had gathered in-

formation regarding industrial preparedness, and it had divided its organization into various sections to deal with special problems. These divisions formed the nucleus for subsequent emergency agencies. However, it had not prepared satisfactory mobilization plans, nor had it developed an organization capable of mobilizing industry and coordinating procurement.

The declaration of war itself created problems which the Council was unable to solve. Various purchasing commissions proceeded energetically and almost ruthlessly toward their separate procurement objectives. The efforts of the Council to coordinate these objectives were nullified by the reluctance of purchasing officials to follow its advice. Confusion, congestion, and sharp price advances inevitably followed the uncoordinated procurement policies and uncontrolled industrial effort. The Council attempted to meet the problem by establishing agencies to centralize and coordinate purchases and economic controls over industry. Thus, in 1917, the Munitions Standards Board, the General Munitions Board, and the War Industries Board were organized, but each lacked the authority necessary for unified control of the war effort.

In the meantime, other emergency organizations were established to deal with difficulties in particular areas of activity. These agencies included the U. S. Food Administration, the U. S. Fuel Administration, the War Trade Board, the War Credits Board, the Railroad Administration, the Purchase, Storage and Traffic Division of the General Staff,

and the War Labor Board. Despite the excellent work accomplished by these agencies, the problem of coordinating economic mobilization remained.

A more satisfactory control arrangement was attained when the President on March 4, 1918, removed the War Industries Board from the Council of National Defense, clothed it with executive authority, and made it responsible for mobilizing the nation's resources as well as for coordinating the procurement program. The essential nature of the Board was lucidly stated in an address before the War College in March, 1921, by its Chairman, Mr. Bernard Baruch:

The War Industries Board was a method of control devised by the President to equalize the strain placed upon the American industrial structure by the war. It endeavored to stimulate and expand production of those materials essential to the war program, and at the same time to depress and curtail production of those things not of a necessitous nature. This was done by regulation in consonance with other executive branches of the basic economic elements: (a) facilities; (b) materials; (c) fuel; (d) transportation; (e) labor; and (f) capital. The method of control was through a preference list upon which were placed those industries whose output was essential to the war's progress. The priority indicated by the preference list was the master key to the six elements named.

Although priorities were used as the principal control device, price-fixing, conservation, the threat of commandeering, and voluntary cooperation of business and industrial leaders were other methods of regulation. This board, because of its authority and close liaison with

other emergency wartime agencies, developed into the over-all control organization of the war effort. It came to be the center of control over commerce, industry, shipping, labor, transportation, fuel, food, and finance. Examination of the organization of the Board shows how the lines of mobilization control were centered in it. The governing board was composed of fourteen members who were heads of various key divisions of the agency, representatives of the Army and Navy Departments, and members of various other offices and agencies of the government. Besides having representation on the executive board, other governmental establishments had agents scattered through the minor subdivisions of the agency.

It took the nation a long time—too long, indeed—to learn that an arrangement of control agencies created piece-meal and not coordinated was not only expensive in terms of time and money, but completely inadequate to meet the requirements of modern warfare. However, once centralization was provided, the prevailing structure became highly effective. After the war, the emergency establishment disappeared.

Although after 1918 the nation as a whole was not interested in mobilization planning, Congress and the War Department, impressed with the economic dislocations engendered during the war period as a result of inadequate mobilization and procurement plans, determined that in the event of another major conflict proper plans would be ready. The National Defense Act of 1920 pro-



vided the necessary authority for coordinating the procurement of the Army and Navy and for mobilizing the nation's resources.

By the terms of this legislation, the Office of the Assistant Secretary of War was directed to supervise the procurement of all military supplies and to devise adequate plans for the mobilization of materials and industrial organizations essential to wartime needs. To accomplish these objectives, the Office of the Assistant Secretary of War was divided into three parts, namely, the Current Procurement Branch, the Planning Branch, and the Army Industrial College. In addition, the Army and Navy Munitions Board was created to study the requirements of fighting forces and to coordinate their needs in peace and in war. This board was directed to make necessary industrial mobilization plans.

From their inception, the Army and Navy Munitions Board and the Planning Branch have made intensive studies of the needs of the armed forces, sources of raw material supplies, available plant facilities for armament production, and arrangements for acquiring necessary supplies with the minimum disturbance to the economic system. In addition, a mobilization plan has been formulated. By reason of the continued work of these organizations it is frequently said, and with justification, that in the event of another war emergency, the nation could start where it left off in the last war, so far as industrial mobilization planning is concerned.

Munich marked a turning point in governmental action regarding war-

time planning. Government departments heretofore lukewarm on the problem of mobilization planning manifested renewed interest in the subject. The Office of the Assistant Secretary of War assumed new importance, and the Army and Navy Munitions Board began to enlist the cooperation of government agencies and business organizations. In August, 1939, President Roosevelt appointed a War Resources Board of seven men to function as a civilian advisory committee to the Army and Navy Munitions Board to perfect the existing industrial mobilization plans. Should the occasion arise, this board was to function as an executive agency with broad powers similar to those of the old War Industries Board. A storm of protest arose over the membership of the board and in September, one month after its creation, the President indicated in a press conference that the War Resources Board was to be disbanded. However, in its final report to the President, the Board expressed its desire to continue to aid the Army and Navy Munitions Board in an advisory capacity. The offer was accepted.

Prior to mid-1940, Congress had made appropriations and authorized contracts for national defense amounting to approximately \$16 billions. Including the aid to Britain, this sum has since expanded to approach \$40 billions. The National Defense Advisory Commission was created in August to "translate this national defense program from appropriations and blueprints into action." It was to determine the need for supplies as well as the sources

and methods of acquiring those supplies. It did not possess executive authority but was to aid in negotiations, facilitate procurement, and in general to serve as a technical advisor to the President. In the meantime, the War Resources Board had remained in a state of suspended animation.

The Commission carried on many necessary activities. It set up a system of priorities and purchasing policies designed to speed defense work and to make the fullest possible use of the nation's resources without disrupting industrial activity. By the end of 1940, it had cleared contracts aggregating more than \$10 billions. In addition, it had made surveys of available supplies of raw materials and of requirements for the defense program, had inaugurated a drive to revitalize the nation's "ghost towns" so as to utilize idle labor and idle plant capacity, had encouraged new plant erection for vital defense manufacture, and had stimulated the development of synthetic substitutes for strategic raw materials. In the circumstances under which it had operated it had functioned most effectively and had accomplished much.

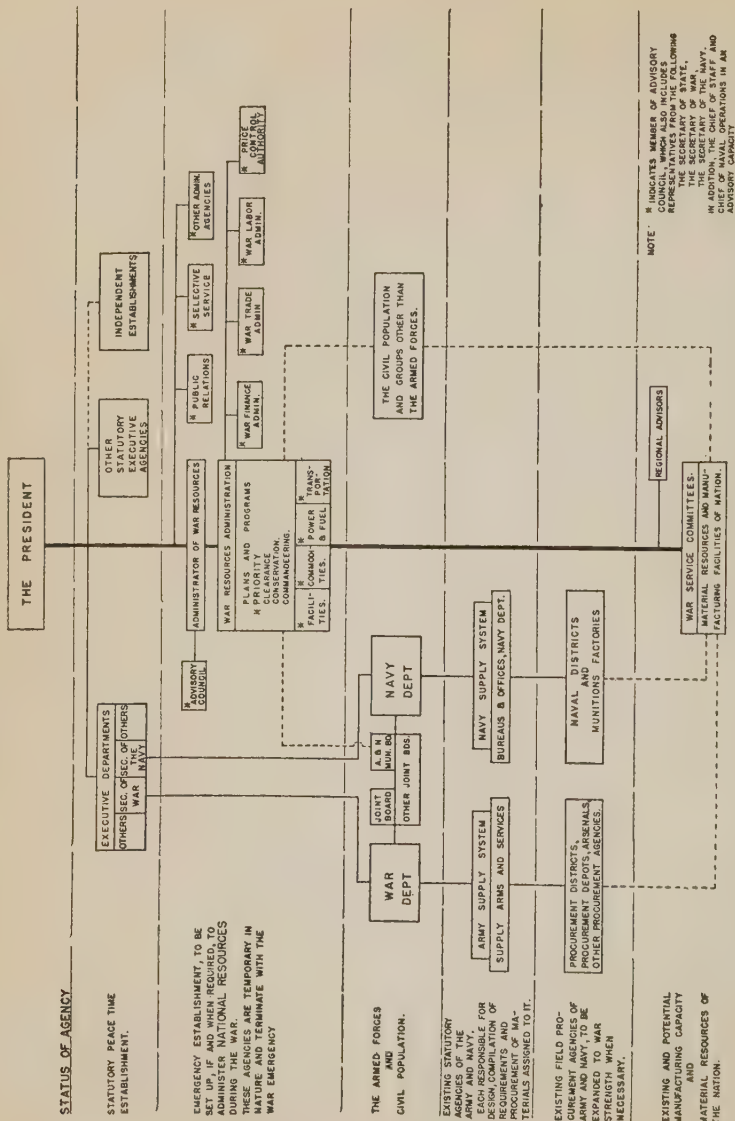
Early in January, 1941, the President's office issued a reorganization order establishing the Office of Production Management as the chief defense organization. This agency was given power which its predecessor sadly lacked. It has the power to act rather than merely to advise. It is charged with the responsibility of using its power to form and execute all measures needed to increase the

supply and production of defense materials, to survey the requirements of the War and Navy Departments and of foreign governments, to coordinate the placement of major defense orders, to take steps to provide an adequate supply of raw materials, to make plans for mobilizing the nation's productive facilities, and to coordinate and consolidate various authorities concerned with national defense. This board, unlike the Commission, is vested with authority to make decisions and to formulate policies without being obliged to consult with the President. The National Defense Advisory Commission continues to operate as an adjunct to the Office of Production Management.

The Office of Production Management is headed by a four-man board composed of Mr. Knudsen, Director General, Mr. Hillman, Associate Director General, and the Secretaries of the Navy and of War. Four principal divisions were established in the agency at the time of its organization, namely, Production, Purchases, Priorities, and Raw Materials. Numerous subdivisions of these larger divisions have been formed as the defense program has developed.

Step by step this organization has built up a series of controls, regulations, and restrictions over economic activities which in the aggregate are tantamount to those adopted by the War Industries Board and those envisioned in the Industrial Mobilization Plan. Priorities have been established over machine tools, aluminum, nickel, magnesium, and other strategic defense materials. Aluminum

# SUGGESTED ORGANIZATION FOR COORDINATION OF NATIONAL RESOURCES AND MOBILIZATION OF INDUSTRY IN TIME OF MAJOR WAR.





output has been allocated according to defense needs. Price schedules have been promulgated for aluminum scrap. Programs have been developed to determine maximum prices for producers in order that unreasonable price advances may be prevented, to license exports, to allocate output if necessary, and to finance, construct, and operate defense plants and arsenals. Recently, a special division was created to assure an adequate supply of skilled labor for defense production. Another subdivision was established to direct conservation, reclamation, and substitution of strategic materials.

As more and more of the nation's human and material resources are devoted to the production of military equipment, it is a virtual certainty that controls and regulations will become more extensive in scope and direction. It is more than likely that the development of the Office of Production Management will closely parallel the organizational structure and assume the same kind of functions that are envisioned in the Industrial Mobilization Plan. Hence, a brief examination of that plan is desirable.

The significance of the existence of a well-fabricated and carefully prepared plan to mobilize industry for war procurement can be realized only when we are reminded of the fact that the absence of adequate plans during the World War came perilously close to causing complete industrial chaos. The 1939 revision of the Industrial Mobilization Plan, the fourth and last official plan published, represents the culmination of over twenty years of intensive plan-

ning work based upon World War experiences. Indeed, there is little in the plan which does not find a precedent in the World War plans.

The official plan is merely the skeleton framework of a larger mobilization strategy which must be found in the intensive wartime powers of the President, unpublished files of the War and Navy Departments, plans of other governmental agencies, and ideas maturing in the minds of key officials. It is, however, this rough framework of the central control agencies in which our interest centers.

Significantly, the mobilization plan, as shown in Chart 1, confirms a principle firmly established by President Wilson that the war activities of a democratic government should not be mixed with the ordinary peacetime functions of the government. According to the plan, the demands of a war emergency are to be met, not by expanding existing governmental establishments, but rather by creating a series of emergency organizations. Ordinary statutory peacetime agencies of government, of course, are to retain their traditional position in government, are to continue their customary duties, and are to administer any assigned mobilization duties for which they are adapted.

The advantage of directing mobilization through emergency rather than existing governmental organizations springs from the fact that without such an arrangement centralized control would become a virtual impossibility. Reluctance to recognize this fact was in part responsible for the failure of improvi-

sation in the last war. New and temporary functions required of government in times of war emergency should logically be performed by new and temporary agencies responsible to the President.

In addition to this feature of the plan it is noteworthy that, in keeping with the policies established during the World War, civilians are to assume control of the mobilization services. New emergency agencies are to be staffed with personnel obtained from among the patriotic business leaders of the nation. Thus, an organization of business and industrial leaders who are capable executives, as well as experts in the tasks assigned to them, would exercise the necessary wartime controls. It is encouraging that present emergency establishments have followed these principles.

The Industrial Mobilization Plan is divided into two parts. The first part is concerned with the utilization of national resources and the mobilization of resources in time of war. The second section is concerned with procurement machinery in peacetime and in wartime.

Recognizing the tremendous confusion and maladjustment created in the early part of the World War as a result of the rather embarrassing competition of various supply bureaus for material, the plan gives effect to a clear understanding of the proposition that the efficiency with which purchasing is accomplished will determine, in large measure, the degree of disturbance caused in the economic life of the nation, the effectiveness with which industrial resources will be utilized,

and the adequacy of the military establishment. Because large quantities of military equipment must be made available in the minimum amount of time, controlled mobilization of resources becomes imperative. The advantage of effective industrial mobilization is lost without careful procurement planning.

Fundamental in both peacetime and wartime procurement is the procurement district. The Navy and each of the seven Army supply services have branches, called procurement districts, scattered throughout the nation. It is the function of these district offices to make purchases, negotiate leases, determine the form of contracts and specifications, report on manufacturing methods, processes, and materials of value to their respective central departments, locate strategic materials, detect plant and material shortages, and distribute industrial capacity so as to match plant facilities with requirements. Upon the basis of information supplied by these decentralized agencies, the central offices of the respective services apportion the volume of purchases to be made in each of the service districts. The branches in turn, independently of the central office, place their allotted purchase requirements among those plants best equipped to manufacture the goods.

In the event of procurement difficulties, the Planning Branch of the Office of the Assistant Secretary of War is notified and various purchases of the Army services are then coordinated. Coordination between the Army and Navy is accomplished through the work of the

Army and Navy Munitions Board. Close liaison is kept with the Office of Production Management and the National Defense Advisory Commission and will be kept, in the event of its formation, with the War Resources Administration proposed in the Industrial Mobilization Plan. Thus, whereas supply services bid independently for materials throughout most of the last war, plans and operations since then have provided close cooperation among procurement agencies.

Pivotal in the wartime emergency mobilization organization is the proposed War Resources Administration. This agency, like the War Industries Board, would control and coordinate industrial mobilization. It would conserve, allocate, control, and direct the nation's human and material resources for the armed forces and for the civilian population. It would apportion production facilities, curtail non-essential manufacture, assign priority schedules, commandeer plants if necessary, and control prices, wages, trade, finance, transportation, and labor pending the establishment of agencies to function in these particular fields of activity. Close contact would be maintained between this establishment and other government organizations. The War Resources Administration, according to the plan, would be the central coordinating and controlling establishment of the industrial mobilization program with authority and control devices in general similar to those exercised by the War Industries Board.

Chart 2 shows the proposed organization of this agency. At the

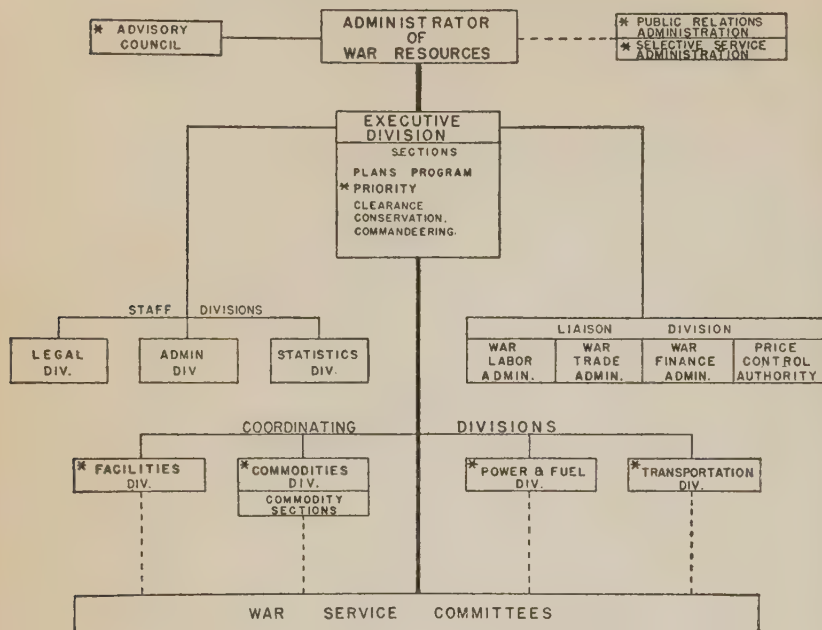
head of the administration would stand the Administrator of War Resources, occupying a position similar to that of Mr. Baruch in 1918-19. The Chairman would be appointed by the President and assisted by an Advisory Council, composed of the heads of various divisions, representatives of any other emergency agencies which may be created, and agents of the State, War, and Navy Departments. Coordination of economic plans and programs would be considered in the Executive Division, which would be assisted by the Staff and Coordinating Divisions. The Coordinating Divisions would apply the policies established by the Administrator of War Resources and the Executive Division. War Service Committees would provide the means of direct contact with industry. A Liaison Division would furnish a necessary link with other control agencies beyond that established by the Advisory Commission.

In planning and controlling mobilization, the work of the Coordinating Divisions would be fundamental. The Facilities Division would be concerned with all government procurement, including that of the fighting forces. Its mission would be to make necessary allocation of existing plant, power, labor, and transportation to procurement agencies when necessary. The Commodities Division, through specific Commodity Sections, would be concerned with maintaining an adequate supply of raw materials to meet the needs of armament and necessary civilian production. To accomplish this objective it would have the



CHART 2

## WAR RESOURCES ADMINISTRATION



Senate Document No. 134, 76th Congress, 2d Session

NOTE: \* indicates that heads of these sections, divisions, or administrations are members of advisory council.

power to ascertain requirements for materials, anticipate and arrange for correcting shortages, apply price controls on particular commodities, encourage the use of substitutes for strategic raw materials, and stimulate the production of vital commodities. The Power and Fuel Division would assure an adequate supply of power and fuel for essential defense industries. Coordination of transportation would be the task of the Transportation Division.

In the last revision of the mobilization plans, provision is made for other emergency organizations, but little is said regarding their structure and functions. It is anticipated that it will become necessary to establish a War Finance Administration composed of representatives of public and private financial organizations. This agency would advise the President regarding financial policies and coordinate and administer those policies. A War Trade Administration is anticipated

to regulate imports and exports by appropriate controls. Machinery for equitably and efficiently distributing labor to industry and to agriculture would be handled by a War Labor Administration. The need for price regulation would be met by a special Price-Control Authority. The dissemination of information to the public would be handled by a Public Relations Administration. Finally, a link between the various administrations and industry would be provided by the establishment of numerous War Service Committees similar to those in operation during the last war.

Briefly, this is the skeleton frame-

work of control organizations provided by the plans for mobilization. Its strength lies in its flexibility, its civilian leadership, and in its centralized control and decentralized action. It is potentially weak in that poor leadership of the super-agency could easily lead to an industrial breakdown.

A continuation of the defense program very likely will lead to an extension of the Office of Production Management in the directions here envisioned in the Industrial Mobilization Plan. To have it develop otherwise would be to ignore the costly lessons of the last World War.

## Financing National Defense

CATHERINE G. RUGGLES

Department of Economics, University of Illinois

THE national defense program is already encountering many problems—for example, problems involving labor, priorities, and price controls. One of the most serious of the difficulties encountered, and the one to be discussed here, is the fiscal problem, or the question of how to pay for the battleships, airplanes, and other materials required for national defense. The function of fiscal policy is to enable the government to get control over the factors of production necessary for national defense. And since it is primarily through the posses-

sion of purchasing power that control over resources is obtained, the aim of fiscal policy is to provide the government with the necessary funds.

There are three possible methods of financing rearmament—by taxation, by borrowing, or by the issue of paper money. The last method does not merit any extended discussion. Although its effects may not be greatly different in some cases from those of borrowing, general disapproval of this method and fear of its consequences make its use inadvisable. Therefore, rearmament

must be financed by borrowing, by taxation, or by some combination of these two methods.

Financing rearmament at present poses a problem different from what it has at any time in the past. Never before have we entered upon such a period with large reserves of unemployed labor and capital. The financial policy appropriate in such a situation differs from that appropriate in a situation of full employment. So long as there are unemployed resources in the economy and production can be increased, if the government borrows through the creation of credit, new goods will be produced and additional taxation will be unnecessary. Taxation involves the sacrifice of income by individuals in order that the government may have more income. As the income of the government is increased and that of individuals decreased, the demand of the government is substituted in part for the demand of individuals. But if there are unemployed resources in the economy, and production and national income can be increased, the increased demand of the government can be satisfied without any reduction in the demand of individuals. If production can be increased, and if "bottlenecks" are not prevalent, borrowing (through credit creation) will not result in rising prices. On the contrary, it will aid in putting unemployed resources to work. As the government increases its expenditures more people are employed, and as more people are employed, the demand for goods increases, and this increased demand for goods leads to further employment.

At this point, it might be argued that the public-spending program of the last decade, which was supposed to operate in the same way, fell short of its objective. There are three fundamental differences, however, between that program and the present program: In the first place, there is general agreement on the necessity of spending for national defense, whereas there was no such general agreement on a policy of spending our way out of the depression. Consequently, present expenditures are not likely to create an atmosphere unfavorable to the expansion of business and thus to be offset by decreases in expenditures elsewhere in the system. In the second place, expenditures for national defense are obviously going to be on a far larger scale than depression expenditures, and for that reason alone may be expected to have a much greater effect. And in the third place, at the present time no solution to the present situation is evident which will make large expenditures for national defense unnecessary in the near future. In recent years there has been continual speculation as to how long large government expenditures for relief purposes would continue to be made. It is obvious at present, however, that the government will have no choice for a long time but to make large expenditures for purposes of national defense. That these expenditures will stimulate an increase in production is, therefore, not to be doubted.

Once full employment has been reached, however, the situation will be different. Taxation, the traditional method of financing the



normal operations of government, also has great advantages in time of war or rearmament. One of these advantages is its tendency to diminish extravagance on the part of the government. Another aspect which is sometimes held to be an advantage is its effect in forcing sacrifices to be made by those who stay at home as well as by those who enter military service. But this argument need not detain us long, for obviously it does not recognize the fact that the materials necessary for rearmament will be obtained by the government in one way or another. It is generally understood today that the burden of a war or of rearmament is borne by the generation living at the time that program is undertaken, and that it is the present generation which must reduce consumption and make the necessary sacrifices. The burden can be shifted to the future only to the extent that capital, human or material, is allowed to depreciate. Furthermore, this argument is somewhat beside the point today, when people at home often give up more than those who go to the "front", and when even the word "front" is losing its significance. Regardless of the method of financing, it is true that, although sacrifices will be imposed upon the people remaining at home, taxation offers the possibility of distributing those sacrifices according to ability to bear them.

The important fact to recognize, however, is that, as the government obtains control over additional funds by means of loans financed by bank credit and increases its expenditures, there will be an increase in indi-

vidual incomes. There is not likely to be much increase, however, in the volume of consumers' goods; in fact, there may even be a decrease, as resources are diverted from producing consumers' goods to producing war materials. Already automobile companies are directing part of their efforts towards producing munitions, firms making women's underwear to making nets, and firms making duck decoys to making shoes. If this situation continues to exist, there will obviously be an increase in prices. Taxation, by reducing individual incomes, will have the distinct advantage of restricting the increase in prices. If taxes are not increased, individuals will not be able to buy any more commodities and services when prices rise than if the government had taken part of their incomes and there had been no increase in prices. In other words, the real incomes of individuals will be reduced in either case—in the one case, by the levy of heavier taxes, and in the other, by rising prices. But although the real income of individuals will be reduced in either case, *the sacrifice involved can be more equitably distributed by means of taxation than by means of rising prices.* Rising prices distribute the reduction in real incomes in an indiscriminate manner and not according to individual ability to bear such a reduction. Those in the lower income groups and those with fixed incomes suffer most during a period of rising prices.

Just exactly how great a volume of taxes a government can levy is a difficult question. Although the taxable capacity of a country is diffi-

cult to measure, it is not unlimited. It depends upon the national income and its distribution, upon the kind of taxes levied, and upon the services provided by the government. The taxable capacity of a country, in fact, is the volume of goods and services which the government can absorb through taxation without causing any decrease in production; this volume will vary from time to time. The absolute limit of taxable capacity is all income above that necessary for subsistence—and, as we are coming to learn, the amount necessary for subsistence is not fixed but flexible, varying from time to time largely because of psychological factors. But in practice taxation cannot take all the excess above that necessary for subsistence without causing a decrease in production. Just how much of that excess the government can take in taxation will be determined in large part by psychological factors. It is readily understood that heavier taxes can be levied in time of war than in time of peace, because of the difference in the attitude of taxpayers. The repressive effects of taxes are likely to be less pronounced in such an emergency than in normal times, because of the stimulus of patriotic motives and because such taxes are believed to be temporary rather than permanent. But even in time of war there comes a point beyond which it is not practicable to increase taxes further, and resort must then be had to borrowing. Inasmuch as borrowing does not create additional resources but merely gives the government further control over existing resources, it is evident that the

taxable capacity of a country is something less than the excess over and above the amount necessary for subsistence.

The recent increase in the rate of the normal tax in England has been made in an effort to keep prices from rising. Part of the increase in the tax, and a larger part in the lower than in the higher income groups, is really a forced loan, which will be returned to the taxpayers after the war is over. This plan was suggested by Mr. Keynes at the beginning of the war as having the important advantage of keeping prices down by reducing consumer incomes (and therefore purchasing power), and thus avoiding the injustices involved in rising prices. It has the additional advantage of restricting the increase in the public debt. Furthermore, for a number of reasons a widespread ownership of the public debt will also be advantageous after the war.

History has made us well acquainted with the disadvantages of financing national defense by means of loans. The inflation which has accompanied past wars has made those wars more expensive to the government because of higher prices for services and materials. But this result has been among the less grievous effects of large-scale borrowing. Among the more serious effects are all the injustices connected with rapid changes in price levels; in the case of inflation, obviously, it is the lower income groups, and especially those with fixed incomes, who suffer most. But the worst effects of large-scale borrowing are not all realized during

the period of borrowing. Two of the most serious effects will be felt in the future. First, a period of inflation is generally followed in practice by a difficult period of depression and readjustment. In view of its recent experience, the present generation is well aware that all steps possible should be taken to prevent the recurrence of such a period of social and economic maladjustment. And second, the creation of a debt raises many problems for the future. Although repayment of the principal may not be absolutely necessary, taxes must be levied to make interest payments. And in spite of the fact that interest payments are nothing more nor less than transfer payments, they will nevertheless have certain grave psychological, economic, and social effects.

Furthermore, the substitution of a policy of borrowing, which absorbs individual savings, for one of taxation may tend to reduce production, or may at least impede any increase in it. As Professor Pigou has noted, people "feel less hard hit" under a system of loans than under one of taxes. This is true because the majority of people give little thought to the taxes they will have to pay in the future for interest on the bonds they buy in the present. Although the very rich may give some thought to the matter, they probably conclude that the taxes they will have to pay for this purpose will be less than the interest they will receive on their bonds. Furthermore, they may also believe that on balance they will pay less taxes than if the war had been financed by taxation instead of by

borrowing. In this belief they are probably correct, since taxes imposed after a war is over are usually less progressive than those imposed in the course of a war. Such was the situation in this country in the case of the Civil War and of the World War. Therefore, since people "feel less hard hit" under a system of loans than under one of taxes, they are less inclined to cut down their consumption, and, as already noted, a reduction in consumption is necessary in order that resources may be diverted to production for war purposes. People are also less apt to save more or to work harder, and consequently production may be less than if a policy of taxation had been followed.

It must be admitted, on the other hand, that to a certain extent an increase in prices as a result of borrowing and credit creation may be truly beneficial. Loans from bank credit, which lead to an increase in prices, may give some stimulus to production. Under the incentives of great rewards, the factors of production may produce more than their normal amount. Even if a country enters a war under a condition that is normally considered to be one of full employment, it will find that production can be further increased. To the extent that borrowing stimulates an increase in production it may lighten the burden of war or of rearmament upon the present generation. The burden of a war is the reduction in consumption which is required; and, of course, the larger total production is, the less will consumption have to be reduced in order to provide the government with a



given quantity of goods and services. It should also be recognized, on the other hand, that increased effort in itself may be regarded as a burden. But the amount by which production can be increased, if full employment has already been reached, is, of course, very limited, and loans from bank credit in such a situation will soon result in rising prices.

When prices begin to rise rapidly, the argument that borrowing is advantageous because it takes funds which can be surrendered conveniently is seen to break down. The assertion is often made that whereas taxes are imposed upon all, regardless of their individual situations, bonds are purchased only by those who can spare the funds conveniently. The latter is true, however, only so long as loans are derived from savings. If the funds come from savings that would otherwise be invested in some other way there will be no increase in prices. Again it will be a case of the demand of the government being substituted for the demand of individuals. Funds which would have been put into private investments previously will now be put into government bonds. Furthermore, individuals may save a larger amount than formerly and thus give the government control over a larger amount of resources. But savings by themselves would not be sufficient for financing a large war. If they were, the burden of a war could be pushed forward to a future generation, since little reduction in consumption, or only such reduction in consumption as would be made voluntarily, would be necessary. The future would suffer to the

extent that it would inherit less capital, since the savings that would have gone into the creation of capital would be used for purposes of defense. But as a matter of fact, consumption must be curtailed sharply for the successful prosecution of a large-scale war. Since savings are inadequate, use must be made of bank credit. Loans which are based upon bank credit, inasmuch as they are inflationary and reduce the purchasing power of all incomes, cannot be said to take funds which can be surrendered conveniently; on the contrary, rising prices undoubtedly work a greater hardship upon the lower than upon the higher income groups.

The period during which an expansionist policy should be followed in order to take up the slack occasioned by unemployed resources will not last long. Although not all of the unemployment may be absorbed, "bottlenecks" are apt to develop, and these "bottlenecks" will lead to rising prices. Once this initial stage has been passed, it is generally agreed that national defense should be financed so far as possible by taxation. Although our taxes have recently been increased and are very high at the present time, it is still possible for us to derive more revenue from taxation. Taxation, as previously explained, is advantageous for several reasons. It furnishes the government with needed revenue, makes it possible to distribute the inevitable sacrifices according to ability to bear them, and restricts the increase in prices. By depriving individuals of part of their incomes and thus reducing their pur-

chasing power, taxation tends to prevent an increase in prices which would involve much distress in the present and which would be likely to create serious problems for the future.

Among the various taxes which might be levied three are outstanding—a sales tax, a flat-rate gross income tax, and a net income tax with lower exemptions and flexible rates. These three possibilities probably rank in inverse order as to ease of administration and equity. The sales tax would be relatively easy to administer and would be very productive of revenue, but since it would take a larger proportion of the incomes of the poorer than of the higher income groups, it would be inequitable.

The suggestion has been made that both the gross income tax and the net income tax be collected at the source at frequent intervals in the same way as payroll taxes are now collected. Such a procedure would overcome one serious objection to the use of taxes in an emergency—the long time that elapses between the imposition of new taxes and the yield of additional revenue. Collection at the source could also be extended to interest and dividend payments. It would not be possible, of course, to collect either of these taxes entirely at the source. In the case of the net income tax, only the normal tax—and not even this in some cases—could be collected at the source, and individual returns would be required from everyone for the payment of surtax, as has been true in England for some years. Such a procedure would have two important

advantages. In the first place, collection at the source would prevent evasion. In the second place, collection at frequent intervals would both provide the government with more revenue promptly and forestall a rise in prices by reducing individual incomes and purchasing power. The rates of these taxes, furthermore, should be readily adjustable. If tax rates are fixed for a year in advance, individual incomes might increase more than anticipated within that period or there might be an unforeseen change in the volume of consumers' goods, either one of which might cause a rapid rise in prices. Professor A. G. Hart has proposed a plan whereby rates could be changed quarterly or even monthly, if necessary, in the light of changes in prices. If prices are rising rapidly, an increase in rates would be indicated in order to prevent consumers from forcing prices still higher.

A gross income tax would be more equitable than a sales tax, since it would be levied in proportion to gross income rather than in proportion to expenditures; expenditures, it is well known, make up a larger proportion of gross income in the lower than in the higher income groups. In comparison with a sales tax or with a gross income tax, a net income tax would be more complicated. The problem of exemptions, for instance, would be a difficult one. But the problems involved would not be insuperable, and the greater equity achieved by such a tax would outweigh its administrative difficulties. Excise taxes should not be completely disregarded, however, in spite

of the fact that they should not be relied upon to furnish much revenue or to reduce individual purchasing power to any great extent. Some special excise taxes will no doubt be necessary to curtail consumption and production in certain lines in which there are shortages of labor and materials, and in non-essential industries.

For further information on this subject the reader is referred to:

- J. M. Keynes, *How to Pay for the War* (New York: Harcourt, 1940)
- A. C. Pigou, *The Political Economy of War* (London: Macmillan, 1940)
- A. G. Hart, *Economic Policy for Rearmament*, Public Policy Pamphlet No. 33 (University of Chicago Press, 1940)